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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 158

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CHARLES J. CANFIELD

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 38–42) is reported in 62 F. (2d) 751. The opinion of the Board of Tax Appeals (R. 24–30) is reported in 24 B.T.A. 480.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933. (R. 42.) By order of this Court dated April 11, 1933, the time within which a petition for a writ of certiorari might be filed was extended to and including June 10, 1933.

(R. 44.) The petition was filed June 10, 1933, and was granted October 9, 1933. (R. 44.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining what part of a distribution declared and paid by a corporation to its stockholders in 1923 represented earnings or profits accumulated prior to March 1, 1913, and was therefore exempt from tax, losses sustained by the corporation in 1915 and 1916 are to be regarded as diminishing the surplus existing on March 1, 1913, or as reducing the profits accumulated between 1916 and 1923.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 21–22.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 23–24) may be summarized as follows:

In 1923, the year in question, the respondent owned 600 of the 15,000 shares comprising the capital stock of the West Side Lumber Company, a California corporation. The par value of each share was $100. (R. 23.)

On March 1, 1913, the company had a surplus of $4,332,684.78, in addition to its original capital of $1,500,000. In the succeeding years, up to April

14, 1923, its earnings and losses were as follows (R. 23):

Year ended—	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
Total	2,455,282.92	404,846.99

Dividends were declared from 1918 to 1923 aggregating $1,290,000. (R. 24.)

On April 14, 1923, the surplus was $5,093,120.71. (R. 23.) On that day, the company declared a dividend of $5,100,000, or $340 per share, of which the respondent received $204,000. (R. 24.)

The Commissioner of Internal Revenue contended before the Board of Tax Appeals that of this dividend 22.75 percent was taxable, as being paid out of earnings accumulated since February 28, 1913, while respondent claimed that only 14.91 percent of it was so taxable. (R. 24.) The difference depends upon the proper application of the losses sustained in 1915 and 1916.[1] These

[1] Throughout the brief, references to taxable years mean the taxpayer's fiscal years ending on February 28th or 29th of the years named, i.e., by losses in 1916, is meant the loss sustained during the year ending February 29, 1916.

losses were treated by petitioner as reducing pre-existing surplus, while the respondent asserted they should be deducted from the income subsequently earned for the purpose of ascertaining the most recently accumulated earnings or profits subject to tax.

The Board of Tax Appeals (seven members dissenting) sustained the ruling of the Commissioner. (R. 24–30.) The Circuit Court of Appeals reversed the decision of the Board. (R. 42.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the most recently accumulated earnings or profits subject to tax as dividends in the hands of stockholders are limited to the net profits realized throughout the entire period intermediate February 28, 1913, and the date of dividend distribution.

2. The Circuit Court of Appeals erred in holding that corporate surplus existing as of March 1, 1913, must be considered as capital and if impaired may be replaced notwithstanding it has actually been risked and in part lost in the conduct of the business prior to the dividend distribution.

3. The Circuit Court of Appeals erred in failing to approve the method employed by the Commissioner of Internal Revenue whereby the taxable status of corporate distributions is fixed by first applying the profits realized in the period immediately preceding the dividend followed by those of

the prior years in inverse order to March 1, 1913, with allowance for dividends earlier paid, treating each year as a separate unit.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

There is no constitutional objection to taxing dividends paid out of corporate earnings accumulated before March 1, 1913, and their exemption from tax is a matter of grace. The exemption must be limited to the express provisions of the statute, which are to be strictly construed. The losses sustained by the corporation in 1915 and 1916 necessarily reduced the surplus of March 1, 1913, since they could not diminish surplus not yet in existence. Distributions of earnings accumulated prior to March 1, 1913, do not constitute a return to the stockholder of part of his capital investment (*Lynch* v. *Hornby,* 247 U.S. 339) and Section 201 does not require that they be so treated. The section does no more than say that such earnings may be distributed free from tax upon the recipients. But if such earnings, instead of being distributed, are risked and lost in the business, later earnings may not be classified as surplus accumulated prior to March 1, 1913, and distributed free from tax.

The reasoning of the court below leads to conclusions so manifestly unreasonable and contrary to fact as to cast grave doubt on the court's interpretation of the Act.

II

The instant case is distinguishable from *Hadden* v. *Commissioner,* 49 F. (2d) 709, upon which the court below relied. In that case there was an operating deficit on March 1, 1913, which had to be made up out of future earnings before there could be an accumulated surplus. In the case at bar there was an earned surplus during all of the period in question. Only gains which create or increase an excess of assets over liabilities constitute "accumulated earnings." Here there were no "earnings or profits accumulated since February 28, 1913" until the year 1917, except for the small profit realized in 1914, which was wiped out by the losses sustained in the two succeeding years.

Section 201 creates a presumption that every corporate distribution is made from the earnings most recently accumulated. The method of computing the tax followed by the Commissioner in this case alone gives effect to the presumption.

III

The decision below is in conflict with established administrative practice which has received the implied approval of Congress through reenactment of the statute without substantial change.

ARGUMENT

I

THE EARNINGS OR PROFITS ACCUMULATED PRIOR TO MARCH 1, 1913, WERE REDUCED BY THE LOSSES SUSTAINED IN 1915 AND 1916, AND THERE IS NOTHING IN THE STATUTE WHICH PERMITS SUCH LOSSES TO BE OFFSET BY EARNINGS ACCUMULATED IN LATER YEARS FOR THE PURPOSE OF RESTORING THE SURPLUS HELD ON MARCH 1, 1913, TO ITS ORIGINAL FIGURE

Subdivisions (a) and (b) of Section 201 of the Revenue Act of 1921, *supra,* provide, on the one hand, that all distributions of corporate earnings or profits accumulated on or after March 1, 1913, are subject to tax upon receipt by stockholders, and, on the other hand, that all such earnings or profits accumulated prior to that time may be distributed free from tax. The problem in this case is to determine, under these provisions, what proportion of the $5,100,000 distribution made by the West Side Lumber Company on April 14, 1923, falls within one category and what proportion falls within the other.

The court below, in reversing the Board of Tax Appeals, held that the accumulated earnings from March 1, 1913, to April 14, 1923, can be ascertained only by deducting the losses of 1915 and 1916 from the total earnings of other years in that period, including the years subsequent to the loss years. It further held that the surplus existing on March 1, 1913, must, for the purposes of the Act, be considered capital, which, if impaired, may be re-

placed out of income before there can be any earnings accumulated subsequent to March 1, 1913.

In *Thorsen* v. *Commissioner,* 65 F. (2d) 234 (C.C.A. 9th),[2] which involves the tax of another stockholder of the West Side Lumber Company with respect to a part of the same distribution, the decision of the Board of Tax Appeals was sustained, and the position of the Commissioner was approved. In that case the court held that earnings accumulated before March 1, 1913, are not to be treated as capital for all income-tax purposes, and that the statute does not authorize restoration of surplus on that date after impairment thereof by losses. We believe that this is the correct view, and that the decision of the court below in the case at bar is unsound.

There is no constitutional objection to taxing dividends paid out of earned surplus accumulated before March 1, 1913. They were taxed under the Revenue Act of 1913, c. 16, Sec. II, A, B, 38 Stat. 114, 166, 167. *Lynch* v. *Hornby,* 247 U.S. 339. The Revenue Act of 1916 exempted such distributions,[3] but, as was said in the *Hornby* case, *supra,* p. 346, this was a grant of "a concession to the equity of stockholders * * * in view of constitutional questions that had been raised in this case, in the companion case of *Lynch* v. *Turrish,* and perhaps

[2] Pending on writ of certiorari, No. 212, October Term, 1933, to be argued with the case at bar.

[3] Sec. 2(a), c. 463, 39 Stat. 756, 757.

in other cases." The later Revenue Acts preserved the exemption,[4] even though constitutionally such dividends could be taxed. *Thorsen* v. *Commissioner,* 65 F.(2d) 234, *supra,* p. 235.

In respondent's brief in reply to the petition for certiorari it was argued that Section 201 is not an exempting clause, but rather defines the dividends which may be taxed, and that therefore the burden is upon the Commissioner to show that the distribution in question was from profits accumulated since February 28, 1913. While the section is, in form, definitive of a part of taxable income, we submit that in reality it is an exemption provision, manifestly designed to avoid the doubts raised in *Lynch* v. *Hornby, supra,* and similar cases. Under the decision in the *Hornby* case dividends constitute income to the recipient, whether distributed from earnings accumulated prior to March 1, 1913, or from earnings accumulated after that date, and the effect of Section 201 is to exempt from tax dividends which would otherwise be taxable.

The limits of the exemption must be found in express provisions of the statute. The words upon which respondent's claim to exemption must stand or fall are the following in Section 201 (b) (*infra,*

[4] See Section 1211 of the Revenue Act of 1917, c. 63, 40 Stat. 300, 336–338; Section 201 of the Revenue Acts of 1918, 1924, and 1926, c. 18, 40 Stat. 1057, 1059, c. 234, 43 Stat. 253, 254, and c. 27, 44 Stat. 9, 10, respectively; Section 115 of the Revenue Acts of 1928 and 1932, c. 852, 45 Stat. 791, 822, and c. 209, 47 Stat. 169, 203, respectively.

p. 21): "any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax." It is not so much a question whether the taxpayer's income falls within other language of the statute as it is a question whether it falls within this language. Unless it can be said that the income of the company during 1917, 1918, 1919, and part of 1920[5] was "earnings or profits accumulated * * * prior to March 1, 1913," it would seem that the decision of the court below must of necessity be reversed. An exemption from taxation is to be strictly construed against the taxpayer, and nothing is to be taken by inference or presumption. A well-founded doubt is fatal to a claim for exemption. *Bank* v. *Tennessee,* 104 U.S. 493, 495; *Bank of Commerce* v. *Tennessee,* 161 U.S. 134, 146; *Morris Canal Co.* v. *Baird,* 239 U.S. 126, 133; *Cornell* v. *Coyne,* 192 U.S. 418, 431; *Yazoo Railroad Co.* v. *Thomas,* 132 U.S. 174.

The court below held, in effect, that there were available for distribution in 1923 all of the earnings accumulated prior to March 1, 1913, in spite of the fact that losses had been sustained in 1915 and 1916. It is submitted that this conclusion is contrary to the facts and involves an erroneous interpretation of the statute. The losses sustained in 1915 and 1916 could serve only to reduce the sur-

[5] The income required to restore earned surplus to the amount held March 1, 1913.

plus existing at that time. Whether or not they were actually charged against prior earnings, their effect must necessarily have been to reduce the excess of assets over liabilities, and, therefore, to diminish the surplus held on March 1, 1913. The gains of later years were yet to come, and a loss suffered before their time could only diminish what the company already had. Cf. *Merriman* v. *Commissioner,* 55 F. (2d) 879, 880 (C.C.A. 1st). By way of illustration, had the company declared a dividend of $50,000 at the close of 1914, there would have been available for distribution, first, the profits realized in that year, and, second, the earnings accumulated prior to March 1, 1913. If after payment of the 1914 dividend the company had decided at the end of 1916 to declare a second dividend, there would have been available for distribution only the balance of the March 1, 1913 surplus remaining after the first dividend had been paid, less the losses sustained in 1915 and 1916. In other words, the assets actually available for distribution at the end of 1916 were less, by reason of the losses, than they would otherwise have been.

There remains the question whether, assuming that the 1915–1916 losses did reduce the March 1, 1913 surplus, there is anything in the statute which permits the replacement of the impaired surplus from earnings subsequently accruing. The court below held that the March 1, 1913 surplus must be regarded as capital, which may be restored before

dividends are paid out of later earnings. We submit that there is nothing in the Act which supports such conclusion. While earnings accumulated prior to March 1, 1913, may be deemed to have become capital in the hands of the corporation so that their receipt by the corporation prior to March 1, 1913, cannot be taxed (*Old Colony Railroad Co.* v. *Commissioner,* 284 U.S. 552), distribution of them to stockholders after that date does not constitute a return of the stockholders' capital investment. *Lynch* v. *Hornby,* 247 U.S. 339, *supra.* Nor, we submit, does the fact that Congress has in the Revenue Act of 1916 and subsequent Acts seen fit to refrain from taxing such distributions show that it intended to characterize as a return of capital something which, as this Court said in the *Hornby* case, would normally be regarded as income. The *Hornby* case shows clearly that we are not concerned here with the status of the earnings in the hands of the corporation, but with their status when received by the stockholder. The decisions of this Court which were cited and relied on by the court below (R. 42)[6] dealt with the status in the hands of a taxpayer of sums received by or accrued to the taxpayer itself prior to March 1, 1913. The statements in those decisions as to the capital nature of such assets would, therefore, seem to have no bearing on the present problem.

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[6] *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330; *Lucas* v. *Alexander*, 279 U.S. 573; and *Old Colony Railroad Co.* v. *Commissioner*, 284 U.S. 552.

The privilege conferred by Section 201 is one which enures to the benefit of the stockholder. The interest of the corporation is, at best, remote and, so far as taxation is concerned, the corporation has no interest. The tax does not fall, either directly or indirectly, upon it. Consequently, the rule for which we contend in no sense deprives the corporation of any right it might have to restore impaired capital. If the corporation chooses to hazard its accumulated earnings in the business, instead of distributing them, there would seem to be no grounds upon which the stockholders could complain. If earnings so hazarded are lost, that concerns the corporation alone, and it is difficult to see whereby the stockholders may insist, contrary to fact, that later gains be designated "earnings or profits accumulated * * * prior to March 1, 1913" and distributed free from tax in place of those lost. Congress has not expressly granted such a right of replacement, and we can conceive of no reason, constitutional or otherwise, for construing the statute as bestowing such right by implication.

The situation is clearly distinguishable from that involved in *Hadden* v. *Commissioner,* 49 F. (2d) 709 (C.C.A. 2d). There the corporation had an operating deficit which had to be made up before there could be any accumulated earnings available for distribution. In so far as the dividend there was not covered by earnings in excess of those re-

quired to restore the deficit, it was regarded as a return to the stockholder of part of his capital investment rather than income. Here the dividends were indubitably income to the stockholder, regardless of the extent to which they were taxable income.

The reasoning of the court below leads to conclusions so manifestly unreasonable as to cast grave doubt on the correctness of that court's interpretation of the statute. Thus, on February 29, 1916, the corporation had an earned surplus of $3,932,432, and on February 28, 1919, its earned surplus amounted to $4,259,566. The rule laid down by the Circuit Court of Appeals would require that the surplus as of February 28, 1919, although in excess of the surplus as of February 29, 1916, be regarded as having been accumulated in its entirety prior to March 1, 1913. Similarly, it follows from the court's reasoning that while the profits of the company realized during the year 1914 were earnings accumulated after February 28, 1913, its income during the period from 1917 to some time in 1920 constituted earnings or profits accumulated on or before that date. It is difficult to see how a construction of the revenue laws which leads to such unrealistic results can be sound.

II

ON THE FACTS OF THIS CASE THE EARNINGS OR PROFITS ACCUMULATED AFTER FEBRUARY 28, 1913, WITHIN THE MEANING OF THE STATUTE, CONSISTED OF THE AMOUNTS EARNED IN THE YEAR 1917 AND SUBSEQUENT YEARS

The issue, as shown above, is whether the West Side Lumber Company's income during the period from the beginning of 1917 to some time in 1920 constituted earnings or profits accumulated prior to March 1, 1913. Whether the income was accumulated on or after that date is relevant only as showing that it did not constitute earnings accumulated before that date. The conclusion of the court below rests mainly upon a statement in the case of *Hadden* v. *Commissioner,* 49 F. (2d) 709 (C.C.A. 2d), *supra,* that accumulated profits since March 1, 1913, must mean the net excess of all profits between that date and the date of distribution over losses sustained between those dates (R. 41).

The lower court, we believe, misconceived the meaning of the statute as to when earnings of a corporation constitute "accumulated" earnings and when they do not. It is important, we submit, in determining how much of earnings or profits a company has accumulated after February 28, 1913, within the meaning of Section 201, whether the company had an earned surplus on that date. Thus, while the procedure approved by the court below—merely ascertaining the net excess of profits over losses during the entire period between March 1, 1913, and the date of the distribution—may be

proper enough in calculating the earnings accumulated since February 28, 1913, where the company had an operating deficit on that date, as in the *Hadden* case, this method does not comply with the requirements of the statute in a situation like that in the case at bar, where the company at all times had a large earned surplus.

The phrase "accumulated earnings or profits" has the same meaning in Section 201 whether directed to the years before or the years after March 1, 1913, and there is nothing to indicate that it was intended to have any other than its usual significance. It means the amount by which a company's assets, by reason of earnings, exceed its liabilities, including capital stock. *Edwards* v. *Douglas,* 269 U.S. 204, 214–216; *Willcuts* v. *Milton Dairy Co.,* 275 U.S. 215, 218, 219; *Hadden* v. *Commissioner, supra,* p. 711. In the absence of such a surplus there are not accumulated earnings or profits, and income which merely decreases an operating deficit and restores impaired capital does not fall within the statutory language. As said in the *Hadden* case, *supra* (p. 711):

> Congress did not intend that a corporation should be held to accumulate profits for one tax purpose only and not for another. No earned surplus can be accumulated until the deficit or impairment of paid-in capital had been made good. Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus even though there are earnings of the tax-

> able year sufficient to pay the dividend in whole or in part. * * *

See also *Willcuts* v. *Milton Dairy Co., supra,* pp. 218, 219. Hence, only gains which create or increase an excess of assets over liabilities become accumulated earnings; and they become such, of necessity, only in the year in which they are made, for it is not until then that they come into existence.

In the *Hadden* case, accordingly, only income remaining after the deficit was wiped out became accumulated earnings, for it alone created or increased distributable earned surplus. In that case, as distinguished from this, early losses of the corporation were from paid-in capital, not from prior earned surplus. That case is manifestly not in point, and the statement therein which was relied upon by the court below should be read in the light of the facts to which it was directed. *Bramwell* v. *U.S. Fidelity Co.,* 269 U.S. 483, 489; *The San Simeon,* 63 F. (2d) 798, 802 (C.C.A. 2d).

In the present case, the company at all times material here had an earned surplus. At no time after February 28, 1913, was income needed or used for any purpose other than to increase surplus already held. True, the losses sustained in 1915 and 1916 diminished surplus, but, as has already been explained, that diminution was, except for the small gain in 1914, of earnings accumulated before March 1, 1913. The 1914 profit was wiped out by the subsequent losses, and no further earnings were accumulated until 1917. At the beginning of the

year 1917 the company possessed a distributable surplus of $3,932,432. Subsequent gains increasing that amount became accumulated earnings—those made in 1917 no less than the ones made in 1922. They all became earnings accumulated after February 28, 1913, and they are all in the category of earnings made taxable upon distribution.

Moreover, subdivision (b) of Section 201 (*infra*, p. 21) creates a presumption that every corporate distribution is made "from the most recently accumulated earnings or profits" to the extent that they were accumulated after February 28, 1913. See *McCaughn* v. *McCahan*, 39 F. (2d) 3, 5 (C.C.A. 3d); *Leland* v. *Commissioner*, 50 F. (2d) 523, 525 (C.C.A. 1st), certiorari denied, 284 U.S. 656; *Christopher* v. *Burnet*, 55 F. (2d) 527, 529 (App. D.C.). The plain import of this language is that in determining what proportion of a corporate distribution is taxable, accumulated earnings must be taken into the reckoning in the inverse order of their accumulation, as the Commissioner and the Board did in this case. This is the only method that satisfies the express provision of the statute. Since the company's gains herein dispute increased accumulated earnings in the years of their production, the Commissioner was required, under this provision, to include them in his computation of earnings accumulated since February 28, 1913.

Petitioner's contention is supported by *Blair* v. *United States*, 63 C.Cls. 193, certiorari denied, 275 U.S. 546. There a corporation at the end of 1918

distributed a dividend of $80,000, and the question was whether it was exempt from tax under Section 201 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1059. The court held it was not exempt, and in so doing necessarily applied the rule for which petitioner contends. The facts in that case parallel those in the instant case. The corporation during 1913, 1914, and 1915 had losses amounting to $157,848.19. During the next three years it had gains of $136,653.79. Thus, after February 28, 1913, losses exceeded gains by $21,194.40. Under the ruling of the court below, the dividend would not have been taxable, and this view would have been proper had there been a deficit on March 1, 1913. But there was on that date a surplus of $106,460.51 (p. 195). The losses in 1913, 1914, and 1915 wiped out the surplus of March 1, 1913, and left the corporation with a deficit on December 31, 1915, of $51,387.58, but the earnings of the next three years after making good this deficit provided a surplus of accumulated earnings sufficient to pay the dividend. The case is directly in point. See also *Edwards* v. *Douglas*, 269 U.S. 204.

III

THE DECISION OF THE COURT BELOW OVERTURNS SETTLED ADMINISTRATIVE PRACTICE WHICH HAS RECEIVED IMPLIED LEGISLATIVE APPROVAL

The procedure followed by petitioner in this case conforms with the established practice of the Bureau of Internal Revenue over a period of many years. A.R.M. 82, 3 Cumulative Bulletin 36 (1920);

G.C.M. 3532, VII-1 Cumulative Bulletin 190, 191–193 (1928). During this time Congress has repeatedly reenacted the substance of the provision involved.[7] The departmental interpretation must, therefore, be deemed to have had the approval of Congress. *National Lead Co.* v. *United States,* 252 U.S. 140; *Brewster* v. *Gage,* 280 U.S. 327, 337; *Universal Battery Co.* v. *United States,* 281 U.S. 580; *Fawcus Machine Co.* v. *United States,* 282 U.S. 375, 378; *McCaughn* v. *Hershey Chocolate Co.,* 283 U.S. 488; *United States* v. *Kirby Lumber Co.,* 284 U.S. 1; *Murphy Oil Co.* v. *Burnet,* 287 U.S. 299. If the administrative practice had been contrary to the intention of Congress, it undoubtedly would have been corrected in later Acts. *Heiner* v. *Colonial Trust Co.,* 275 U.S. 232, 235; *Massachusetts Mutual Life Ins. Co.* v. *United States,* 288 U.S. 269, 273.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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NOVEMBER 1933.

[7] See note 4, *supra*, p. 9.

APPENDIX

Section 201 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 228, provides in part:

> SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of

(1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

* * * * *

Treasury Regulations 62 (1922 ed.), promulgated under the Revenue Act of 1921, provide in part:

ART. 1542. *Source of distribution.*—(*a*) For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913;

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ART. 1543. *Distribution out of earnings or profits accumulated prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, * * * is not a dividend within the meaning of the Act. * * * A corporation cannot distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. In determining whether a dividend is out of earnings or profits accumulated prior or subsequent to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

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